

**DECISION**

18821 *Suptr*  
**THE COMPTROLLER GENERAL  
OF THE UNITED STATES**  
WASHINGTON, D.C. 20548

**FILE:** B-198074**DATE:** July 15, 1981**MATTER OF:** Funding of Replacement Contracts

- DIGEST:**
1. An agency's original obligation of funds for a contract remains available for a replacement contract awarded in a subsequent fiscal year where: (1) existing contract was terminated for default and that termination has not been overturned by a Board of Contract Appeals or a Court; or (2) replacement contract has already been awarded by the time a competent administrative or judicial authority converts the default termination to a termination for convenience of the Government.
  2. An agency's original obligation of funds for a contract is extinguished and thus not available for a replacement contract where: (1) existing contract was terminated for convenience of the Government on agency's own initiative or upon recommendation of GAO; or (2) existing contract was terminated for default and agency has not executed a replacement contract prior to order by competent administrative or judicial authority converting default termination to a termination for convenience of the Government.
  3. A replacement contract awarded after original contractor has defaulted may be supported by the original obligation of funds even if awarded in a subsequent year if it satisfies the following criteria: (1) it must be awarded without undue delay after original contract is terminated; (2) its purpose must be to fulfill a bona fide need that has continued from the original contract; and (3) it must be awarded on the same basis and be substantially similar in scope and size as the original contract.

The Environmental Protection Agency (EPA) requested a decision on the source of funding for replacement contracts. The EPA's questions arose in connection with EPA contract Number 68-03-6064 with Yale Industrial Trucks, Baltimore/Washington, Inc. However, some of the questions apply to hypothetical situations that are different from the contract situation. The answers given below reflect the different rules applicable to different sets of facts.

*[Clarification on Source of Funding for Replacement Contracts]*  
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EPA awarded a contract on February 22, 1979, for an electric fork lift truck in the amount of \$18,258. On June 26, 1979, in accordance with the terms and conditions of the contract, the Agency terminated the contract for default for failure of the contractor to furnish the required equipment by the revised delivery date of June 25, 1979. On July 19, 1979, Yale filed a Notice of Appeal with the Agency, pursuant to the contract's disputes clause. On June 27, 1979, one day after it terminated the Yale contract, EPA awarded a replacement contract in the amount of \$20,923 to Clarklift of Detroit, Inc. The contract was funded from the same appropriation as the earlier contract and Yale was billed for the excess costs.

In order to clarify what funds are available in this and similar situations, EPA has requested us to respond to the following questions:

Question #1:

"Should the funds originally obligated for the defaulted contract be deobligated in situations where actions of the Contracting Officer are being appealed by a defaulted contractor?"

Answer: No, certainly not prior to the time that a decision on the propriety of the default termination has been rendered. (See also our answer to question 2.)

When a contract is terminated for default, the funds obligated for the contract generally remain available for a replacement contract whether awarded in the same or the following fiscal year. 34 Comp. Gen. 239 (1954), 55 id. 1351 (1976). The obligation established for the original contract is not extinguished because the replacement contract is considered to represent a continuation of the original obligation rather than a new contract. 34 Comp. Gen. 336 (1955). This rule was founded on policy considerations as early as 1902 (9 Comp. Dec. 10,) and with a few special exceptions, has been maintained by this Office ever since. See, for example, 55 Comp. Gen. 1351 (1976). The primary reason for the rule was to facilitate contract administration. Under a termination for default clause, the Government can terminate the contract when the contractor's performance fails to satisfy critical requirements of the contract. The default clause provisions allow the Government to repurchase the terminated performance and charge the defaulted contractor for any excess costs. This repurchase arrangement became known as a replacement contract. If all replacement contracts were treated as new contracts, an agency whose contractor defaults would be required to deobligate prior year's funds which support the defaulted contract, and reprogram and obligate current year funds, even though the particular expenditure was budgeted for the prior year. Because contractor defaults can neither be anticipated nor controlled, a great deal of uncertainty would be introduced into the budgetary process. In some cases agencies would have

to request supplemental appropriations to cover these unplanned and unprogrammed deficits which could result in costly program overruns. The rule, therefore, avoids many administrative problems that cause procurement delays.

We said earlier that generally funds obligated for the original contract may remain available to fund a replacement contract in default situations. There are a few caveats. The replacement contract must be made without undue delay after the default and there must still be a bona fide need for the goods or services. Also, the replacement contract must be awarded on the same basis as was the original contract, except for the total cost. A procurement which differs markedly in scope, nature and size will be regarded as a new contract rather than a continuation of the old one.

Returning to the circumstances of the Yale contract presented by EPA, we observe that the source of funding for the replacement contract will be unaffected by the eventual outcome of the contractor's appeal of the default determination. The replacement contract was awarded one day after the termination, in the middle of the fiscal year. Therefore, even if the termination was later held to be for convenience rather than default, and the replacement contract was considered to be a new obligation, the same year's funds could be used. 35 Comp. Gen. 692 (1956), 44 id. 399 (1965).

Question #2:

"If \* \* \* the contractor wins his appeal in the next fiscal year, are the costs to be funded from the original funding appropriation or from funds current at the time of settlement?"

Answer: When a contractor, whose contract is terminated for default, appeals that action to the agency's Board of Contract Appeals and is successful in overturning that determination in a subsequent fiscal year, the Board normally converts the default to a termination for convenience of the Government. See Federal Procurement Regulations (FPR) 1-8.707(e) (FPR Amendment 182 August 1977) and Defense Acquisition Regulation (DAR) 7-103.11 (DPC 76-6, January 31, 1977). B-197279 September 29, 1980.

If the replacement contract already has been awarded by the time the agency's Board converts the default termination to a convenience termination, no deobligation of the prior year's funds will be required. The original obligation may continue to support the replacement contract.

Because the charge to the original obligation was proper at the time the replacement contract was awarded, we do not think the charge should be retroactively declared improper, thereby creating an Antideficiency Act violation casting doubt on the validity of the contract, and placing a burden on the

agency to retroactively adjust its accounting records. This is an additional reason why we advised that there is no reason to deobligate the funds charged to the original obligation for the replacement contract pending the outcome of the appeal by Yale.

On the other hand, if, in a subsequent fiscal year, the Board of Contract Appeals ordered conversion of the default termination to a termination for convenience, and, hypothetically, the replacement contract had not yet been awarded, the original obligation would no longer be available for a replacement contract. This is true whenever a contract is terminated for the convenience of the Government, whether the action is taken at the agency's initiative, pursuant to a recommendation from the General Accounting Office, or as a result of a Board-ordered conversion. Any subsequent contract, even if labeled "replacement" and closely resembling the old contract must be regarded as a new contract and must be charged to the fiscal year funds current at the time the new contract is awarded.

Question #3:

"The general rule stated by your office is that 'replacement contracts may be charged to the same appropriation obligated with the defaulted contract, etc.' Based on a similar situation as the Yale transaction described above (and assuming the replacement contract is awarded within a reasonable time), if a replacement contract was not awarded until the next fiscal year, should the additional cost be funded from the original appropriation or the appropriation current at the time of the replacement award?"

Answer: As indicated above, funds obligated under the original contract would be available for the purpose of engaging another contractor to complete the unfinished work. 34 Comp. Gen. 239, above. Since the "bona fide" need is viewed as continuing, the entire cost of the replacement contract must be charged to the appropriation current at the time the need arose. See 42 Comp. Gen. 272, 275 (1962). Legally, the defaulting contractor is liable to the Government for the additional cost of the replacement contract. However, recovery of such funds by the Government may be subject to a great deal of uncertainty and delay if the defaulting contractor is insolvent or for other reasons. Hence, the agency may utilize unobligated funds, if any, from its prior year's appropriations to increase the amount of obligations chargeable in that year for the original contract in order to pay the replacement contractor the full amount owed, (while continuing to attempt collection from the defaulting contractor, of course.) 59 Comp. Gen. 518 (1980).

Summary

The rules governing the source of funding for replacement contracts are as follows.

A. The original funds remain obligated and available for funding a replacement contract, regardless of the year in which the replacement contract is awarded:

- (1) where the contracting officer terminates an existing contract for default on the part of the contractor, and the determination that the contractor defaulted has not been overturned by a Board of Contract Appeals or a Court; or
- (2) where a replacement contract has already been awarded, after an agency terminates for default, by the time a competent administrative or judicial authority converts the default termination to a termination for convenience of the Government.

In both situation, the replacement contract must satisfy certain general criteria to be considered a replacement, as opposed to a new, contract. First, it must be made without undue delay after the original contract is terminated. Second, its purpose must be to fulfill a bona fide need that has continued from the original contract. Finally, it must be awarded on the same basis and be substantially similar in scope and size as the original contract.

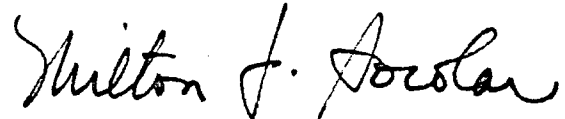
B. The original funding obligation is extinguished upon termination of the contract and the funds will not remain available to fund a replacement contract:

- (1) where the contracting officer terminates an existing contract for the convenience of the Government, either on his own initiative or upon the recommendation of the General Accounting Office; or
- (2) where the contracting officer has terminated an existing contract for default and has not executed a replacement contract on the date that a competent administrative or judicial authority orders the conversion of the original termination for default to a termination for convenience of the Government.

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In these situations, the original obligation must be deobligated to the extent it exceeds termination costs. Any subsequent contract awarded must be regarded as a new contract chargeable to appropriations current at the time of the new award.

C. With reference to the specific facts of the Yale contract situation, FY 1979 appropriation may be charged with the costs of the Clark lift replacement contract regardless of the eventual outcome of Yale's appeal.

A handwritten signature in dark ink, reading "Milton J. Fowler". The signature is fluid and cursive, with the first name "Milton" being the most prominent.

Acting Comptroller General  
of the United States